

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-6191

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Petitioner-Appellee,

v.

MORGAN GUARANTY TRUST COMPANY,

Respondent,

and

ROGER L. KEECH and SANDRA J. KEECH,

Intervenors-Appellants.

On Appeal from the United States District Court for the
Southern District of New York

**REPLY BRIEF FOR INTERVENORS-APPELLANTS,
ROGER L. KEECH AND SANDRA J. KEECH**

BENDER & FRANKEL,
*Attorneys for Intervenors-Appellants,
Roger L. Keech and Sandra J. Keech,
225 Broadway,
New York, New York 10007
(212) 227-6000*

LOUIS BENDER
SANDOR FRANKEL
Of Counsel

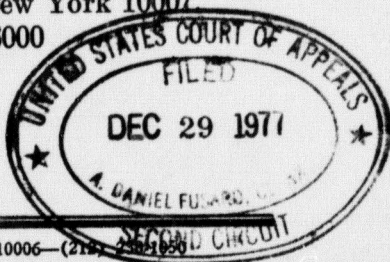


TABLE OF CONTENTS

	PAGE
REPLY BRIEF FOR INTERVENORS-APPELLANTS	1-12

Cases Cited

Donaldson v. United States, 400 U.S. 517 (1971)	4, 6-10
United States v. Billingsly, 469 F.2d 1208 (10th Cir. 1972)	6
United States v. Church of Scientology of California, 520 F.2d 818 (9th Cir. 1975)	3
United States v. Diracles, 439 F.2d 795	7
United States v. Hodgson, 492 F.2d 1175 (1974)	6, 7
United States v. LaSalle National Bank, 554 F.2d 302 (7th Cir. 1977), cert. granted — U.S. —, December, 1977	2, 6-8
United States v. McCarthy, 514 F.2d 368 (3d Cir. 1975)	6
United States v. Troupe, 438 F.2d 117 (8th Cir. 1971)	6, 7
United States v. Weingarten, 473 F.2d 454, n. 11 (6th Cir. 1973)	7
United States v. Werner, M 18-304 (S.D.N.Y. Nov. 22, 1977)	5
United States v. Wright Motor Co., Inc., 536 F.2d 1090 (5th Cir. 1976)	3
United States v. Zack, 521 F.2d 1366 (9th Cir. 1975)	10

	PAGE
Statutes Cited	
18 U.S.C.:	
Sec. 7602	10
26 U.S.C.:	
Sec. 7201	4

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Petitioner-Appellee,

v.

MORGAN GUARANTY TRUST COMPANY,

Respondent,

and

ROGER L. KEECH and SANDRA J. KEECH,

Intervenors-Appellants.

On Appeal from the United States District Court for the
Southern District of New York

**REPLY BRIEF FOR INTERVENORS-APPELLANTS,
ROGER L. KEECH AND SANDRA J. KEECH**

The Government's answering brief makes certain observations which should be examined in order to correctly understand the issue before this Court on appellants' appeal from the Order below.

In its statement of facts the Government alleges that the affidavits submitted by the Government (which are an affidavit of the Special Agent and one of the Revenue

Agent) "demonstrate" that the investigation is "to determine the extent, if any, of the taxpayers' civil liability for additional taxes and/or for civil fraud penalties . . ." (Govt. Brief, p. 3). Having said that, the Government then proceeds to add further that "the 'facts' proffered by taxpayers are not inconsistent in any material respect with those summarized above" (Govt. Brief, p. 5). Indeed, the Government notes further with respect to the affidavits submitted by the Government in referring to the impact of any Supreme Court decision in *United States v. LaSalle National Bank*, 554 F.2d 302 (7th Cir. 1977), cert. granted — U.S. —, December, 1977, that "a decision adverse to the Government would not aid taxpayers here because *uncontroverted affidavits* submitted by the IRS agents involved establish that the instant summons was issued to develop information needed to resolve both the civil and the criminal aspects of the investigation" (emphasis added) (Govt. Brief, p. 13).

What the Government apparently has done is to interpret the affidavits submitted by the Special Agent and the Revenue Agent because in the appendix citation for the statement as to what the affidavits "demonstrate", there is no assertion by either agent that they are conducting an investigation "of the taxpayers' civil liability for additional taxes and/or civil fraud penalties." The Special Agent asserts as to his function that "I was assigned to the investigation of the 1973, 1974, and 1975 tax returns of Sandra J. Keech and Roger L. Keech in February, 1977" (A 25). The Revenue Agent indicates that "in my capacity as an Internal Revenue agent, I was assigned to a joint investigation being conducted by the Audit and Intelligence Divisions . . . to ascertain the correctness of the tax returns filed . . ." The erroneous conclusion made by the Government that the investigation was to determine civil liability may be true but that fact was not apparent from the agents' affidavits and could

have only been determined if at all, we submit, had the District Court below granted appellants the hearing they requested. The affidavits themselves do not, as the Government contends, demonstrate that civil tax liability was a function of this investigation.

Appellants submitted an affidavit to the Court below indicating that a witness was prepared to testify that the Special Agent had stated that he was conducting a criminal investigation of the appellants. The Special Agent in his supplemental affidavit denied the statement attributed to him. A disputed issue of fact arose by virtue of the conflict between these affidavits which appellants indicate in their main brief "obviously could not be resolved solely on the affidavits but require an evidentiary hearing." We noted that even in the face of an express denial by the special agent, "a summoinee must be afforded at least some opportunity to substantiate its allegations." *United States v. Wright Motor Co., Inc.*, 536 F.2d 1090, 1095 (5th Cir. 1976) (emphasis in original), quoting with approval from *United States v. Church of Scientology of California*, 520 F.2d 818, 824 (9th Cir. 1975) (Appellants' main brief, p. 6).

Accordingly, on the contrary the facts stated by the Government in its statement of facts are inconsistent with the facts proffered by the taxpayers, and the affidavits submitted by the Government are not uncontroverted affidavits but contradicted.

Also contrary to the Government's assertion that the investigation being conducted by the agents is to determine civil liability for additional taxes and/or civil fraud penalties is the affidavit of the Special Agent who asserts that any civil tax liability will be investigated or determined only after he has made a determination as to whether he will or will not recommend criminal prosecution. The Special Agent says:

"I do know that if I determine not to recommend criminal prosecution the Audit Division will then decide whether there exists any additional tax liability for the years in question and whether to seek penalties against the taxpayers for civil fraud." (A 26, ¶ 3).

As the Special Agent sees it, no civil tax liability will be investigated or determined until after he gets out. Thus, the Revenue Agent assigned to him on the joint investigation does so in order to develop proof for criminal purposes, including but not limited to one of the elements of the offense of tax evasion in Section 7201, Title 26, U.S.C., i.e., the attempt to evade a substantial or a large part of the tax due and owing, which is the standard indictment language. The Government concedes this in its brief when it states:

"Of course, any determination of correct liability as distinct from the liability the taxpayers originally reported will be critical to a determination of a willful underreporting of income, see 26 U.S.C. §§ 7201 *et seq.*" (p. 4)

The Government asserts that appellants were not entitled to a hearing because they made conclusory allegations of bad faith and therefore under decisions such as *Donaldson v. United States*, 400 U.S. 517 (1971) and two unreported decisions in the Southern District of New York, as well as a Ninth Circuit Court case (Govt. Brief, p. 9 and fn.), the appellants were not entitled to a hearing. None of these cases, we submit, supports the Government's contention that appellants' showing below is "conclusory" and that the denial of an adversary hearing is supported. The *Donaldson* case dealt with the issue of whether the taxpayer should have a right of intervention and under what circumstances

intervention may as a matter of discretion be permitted by the District Court. It did not deal with the nature of the showing that had to be made in a proceeding such as this, except to note that intervention may be permitted if the taxpayer disclosed that it had a protectable interest in the properties summonsed or that the attorney-client privilege existed. *United States v. Manufacturers & Traders Bank*, cited by the Government (p. 9 fn.) is likewise no support for the Government's contention that appellants' showing below is "conclusory". There is no showing in that opinion as to what the taxpayer offered as supporting proof, the Court simply holding:

"The affidavits are insufficient to support allegations that the summons was issued in bad faith."*

Garrett v. United States, also cited by the Government (p. 9 fn.), does not support the Government's contention that appellants' affidavits are "conclusory". Indeed, if anything, the Ninth Circuit in that case disputes the contention advanced by the Government that appellants' affidavits are "conclusory". Thus, the Circuit Court noted:

"The rationale of *Donaldson*, that intervention absent a showing of a 'significantly protectable interest' should not be allowed to frustrate administration of the tax laws . . ., is equally applicable to taxpayers' additional allegations, *particularly as the taxpayers have offered nothing factually to support them.*" (511 F.2d 1037, 1038 (1975)) (Emphasis added)

* *United States v. Werner* (S.D.N.Y. Nov. 22, 1977), M 18-304, also cited (p. 9 fn.), could not be located. An appeal was filed in this Court December 21, 1977 (T 8250) but the file was not in the Docket Room of the District Court or on file in this Court as yet.

The existence of appellants' witness prepared to testify that the Special Agent said he is conducting a criminal investigation demonstrates *prima facie* evidentiary support for appellants' contention that the investigation conducted by the Special Agent is for an improper purpose, that is, solely to secure evidence for criminal purposes.

This factual allegation of the Special Agent's purpose was sufficient to warrant a hearing in *United States v. McCarthy*, 514 F.2d 368 (3d Cir. 1975) (referred to in appellants' main brief, pp. 7, 11, 12, 17). It is to be further noted that in *United States v. LaSalle National Bank*, 554 F.2d 302 (7th Cir. 1977), cert. granted — U.S. —, Dec. 1977, where respondent's witness Perry testified that the Special Agent told him "his investigation [of the taxpayer] was strictly related to criminal violations," there was a sufficient showing to cause the District Court to examine the Intelligence file in camera and conclude notwithstanding the Special Agent's testimony that one of his purposes "was to determine the tax liabilities for the years under investigation" that the Special Agent's investigation was solely for criminal purposes.

The Government requests that this Court adopt an interpretation of *Donaldson v. United States* which is contrary to every Circuit Court of Appeals that has addressed the problem except possibly the Eighth Circuit in *United States v. Troupe*, 438 F.2d 117, 119 (8th Cir. 1971).^{*} This is true with respect to the First, Third, the

^{*} While *United States v. Billingsly*, 469 F.2d 1208 (10th Cir. 1972) from which the Government quotes (Govt. Brief pp. 11-12) seems to adopt an interpretation similar to *United States v. Troupe*, a later decision of the Tenth Circuit in *United States v. Hodgson*, 492 F.2d 1175 (1974), indicates it is in accord with the majority of the Circuits, i.e., that even though there has been no recommendation to the Justice Department, if the summons was issued in aid of a criminal investigation, it will be considered not issued in good faith under

(Footnote continued on following page)

Fifth, the Sixth, the Seventh, the Ninth, and the D.C. Circuits, as indicated in the cases referred to in appellants' main brief at pages 15-17.

In *United States v. LaSalle National Bank*, the issue addressed by the Court of Appeals was:

"[T]he real issue before the court is whether the Internal Revenue Service may issue a summons solely in aid of a criminal investigation and still meet the standard of good faith as enunciated in *Donaldson*." (554 F.2d at 308-309)

"Our reading of the reported cases persuades us that the use of an administrative summons solely for criminal purposes is a quintessential example of bad faith" (554 F.2d at 309).

This issue somehow takes on a different cast in the Government's reference to the issue in that case which the Government says is:

"[T]he Supreme Court has granted certiorari to determine whether an

'Internal Revenue Summons [may] properly be issued to obtain third-party records in aid of administrative investigation conducted by IRS to determine whether it should recommend to Justice Department that taxpayer be prosecuted for criminal tax violations.' 46 U.S.L.W. 3226 (Oct. 4, 1977)." (Govt. Brief pp. 12-13)

(Footnote continued from preceding page)

Donaldson. (*United States v. Hodgson*, 492 F.2d *supra*, at 1177). In *United States v. Weingarten*, 473 F.2d 454, 460, n. 11 (6th Cir. 1973), the decision in *Troupe* was criticized. The Circuit Court noted that in a later case, *United States v. Diracles*, 439 F.2d 795, 796, the Eighth Circuit is in accord with their analysis of *Donaldson*. This Court has not written on this slate as far as we can determine.

It is true that a resolution by the Supreme Court of the issue in the *LaSalle National Bank* case favorable to the Government would dispose of taxpayers' present appeal, as the Government asserts. Under such circumstances the Supreme Court would of necessity have decided that a summons was valid even if it was issued in an investigation solely for criminal purposes. Contrary to the Government's assertion (Govt. Brief p. 13), however, that a decision adverse to the Government would not aid the taxpayers is simply not true because the Government's affidavits were controverted, and, if the appellants' proof was sustained, the summons would not be enforceable since it would have been issued in aid of an investigation solely for criminal purposes.

In urging this Court to adopt its interpretation of *Donaldson*, the Government fails to address itself to the statement in *Donaldson* set out in appellants' main brief (at pp. 14-15) that in referring to the opinion in *Reisman v. Caplin* the Supreme Court in *Donaldson* said that the language in *Reisman* is "applicable to the situation of a pending criminal charge or, at most, of an investigation solely for criminal purposes." (400 U.S. at 533). The Government thus overlooks the distinction between an investigation solely for criminal purposes and one where there is an investigation to determine civil tax liability which could lead to a possible criminal prosecution. In this respect it says that in every case, as *Donaldson* holds, there is no meaningful line that can be drawn between civil and criminal purposes prior to a recommendation of criminal prosecution. *Donaldson*, we submit, is misread. The Government quotes from *Donaldson* (at p. 8)

"To draw a line where a special agent appears would require the Service, in a situation of suspected but undetermined fraud, to forgo either the use of the summons or the potentiality of an ultimate recommendation for prosecution."

We submit that what *Donaldson* is saying is that when a Special Agent investigates a situation where he suspects but has no knowledge or proof of fraud, the issuance of a summons will be valid until he makes a recommendation for prosecution. At the same time, we submit, that what *Donaldson* also says in this quote is that if the Special Agent no longer suspects fraud but has proof of it or has determined its existence even before a recommendation for prosecution, the investigation would not be in good faith but would be an investigation solely for criminal purposes. This is exactly what *Donaldson* says in its reference to the *Reisman* dictum to which reference has just been made and to which the Government fails to mention or respond although it was argued in appellants' main brief (at pp. 14-15).

With reference to the appellants' argument that because two of the years under investigation have been examined and no tax deficiencies found to be true, this should have been considered by the District Court as an additional factor on the issue of the purpose of the investigation, the Government says the argument is "frivolous" (p. 14). The Government argues that if appellants' position was correct, i.e., once civil liability has been determined the IRS could not issue a summons, it would mean the IRS was forever barred from using an administrative summons to discover unreported income concealed in a tax examination (p. 14). But what the Government overlooks is that the appellants argue (1) that no civil tax liability is a factor to be considered in determining if the summons was issued solely in aid of a criminal investigation (Appellants' brief, p. 9), not as contended by the Government that the appellants' claim that this fact alone proves an abuse of the Court's process, and (2) that at a hearing it may well appear that the agents had sufficient information to indicate and prove that the appellants had concealed unreported income which would be another fac-

tor, the appellants argue, in suggesting that the investigation was solely for criminal purposes (Appellants' brief, p. 11).

The Government further misreads appellants' argument in saying that the appellants "assert that the fact . . . the summons was issued by a special agent suggests bad faith on the part of the IRS" (Govt. Brief, p. 14). The appellants did not make such a contention but on the contrary stated that "the presence of a special agent does not conclusively establish that the investigation is solely for criminal purposes", citing *Donaldson* (Appellants' Brief, p. 5). What the appellants did say is that in support of a determination that an investigation is solely for criminal purposes, that is a factor to be considered since the Special Agent is concerned primarily with criminal enforcement, citing *United States v. Zack*, 521 F.2d 1366, 1369 (9th Cir. 1975) (Appellants' Brief, p. 5).

There isn't anything extraordinary in denying to the IRS the right to an administrative process where it is engaged solely to secure evidence for criminal purposes. This does not stop its power to investigate criminal violations of the Internal Revenue Code any more than the lack of such process has impeded the F.B.I. in determining criminal violations of Title 18, U.S.C. The Courts of Appeals are almost unanimous in their interpretation of *Donaldson v. United States* and the Congressional intent under Section 7602 that a summons issued in an investigation solely for criminal purposes is invalid. Congress, we submit, was more interested in collecting the revenue from some 80,000,000 taxpayers who could be affected by an abuse of process than catching the 2,037 taxpayers against whom prosecution was recommended, as the Government notes in its brief (p. 12 fn.). Congress, we submit, in enacting 7602 was primarily concerned with civil collection, not solely criminal penalties, as the ma-

majority of the Circuit Courts hold in their interpretation of *Donaldson v. United States*.*

The Government finally argues that it cannot understand how the evidence offered by appellants below that the Special Agent had stated he was conducting a criminal investigation could be considered as evidence "that there is no civil purpose which is being pursued simultaneously in the investigation." (Govt. Brief, p. 15). As we have argued both in our main brief (p. 6), and here, on its face such a statement by the Special Agent would seem to indicate that the sole purpose of the summons is to aid in a criminal investigation. Such a statement, we argued further, is not the same as showing that the Special Agent is conducting a civil investigation or both a criminal and civil investigation, or that he is conducting simply "an investigation of the tax returns" of appellants. Certainly without a hearing appellants were deprived of an opportunity to develop that there was no civil purpose, or on the other hand for the District Court to determine that

* The extent to which this summons power can be abused was noted in the Report on Administrative Procedures of the Internal Revenue Service to the Administrative Conference of the United States (S. Doc. 94-266, Oct. 1974, p. 735), as follows:

"The individual [taxpayer] so summoned is often under the perceived threat of substantial civil and criminal penalties for failure to comply with the summons. In addition, rightly or wrongly, he may fear becoming the object of a yearly IRS audit or other harassment if he fails to cooperate.

"The Service compiles no statistics about the issuance of summonses by its employees. It does not know how many summonses are issued, by whom, for what purposes. It does not know the number of summonses with which taxpayers or other summoned parties do not voluntarily comply. The Service also lacks statistical records about the seeking of judicial enforcement of summons and the results thereof."

the Government was correct, that is, that the District Court would find that notwithstanding that statement by the Special Agent as to a criminal investigation, there did exist a concomitant civil purpose.

The Government cites the so-called *Miranda* warning excerpted from the Manual for Special Agents which the Special Agent is required to give a taxpayer who is a target of the investigation. We submit the requirement of such a warning is further proof that in seeking to interview the taxpayer the investigation has reached such a point that the Special Agent either has determined to recommend criminal prosecution or has formed a firm purpose to that effect, in either of which events his investigation would be solely for criminal purposes.

For the reasons set forth above, and for the reasons set forth in appellants' main brief, it is respectfully submitted that the Order of the District Court should be reversed, and the case should be remanded to the District Court for that Court to conduct an evidentiary hearing, with appropriate discovery, with respect to the issue of whether the summons in question was issued for the sole purpose of a criminal investigation.

Respectfully submitted,

BENDER & FRANKEL,
Attorneys for Intervenors-Appellants,
Roger L. Keech and Sandra J. Keech.

LOUIS BENDER
SANDOR FRANKEL
Of Counsel

2
COPY RECEIVED
Robert B. Gable
UNITED STATES ATTORNEY
12/29/72
Maurice J. Bryant